Case Study

Debt-for-education swaps: Cases between Spain and Latin American countries

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Introduction

In 2005, the Government of Spain announced debt-for-education swap, a program that re-lieved the debt of several developing countries in exchange for a commitment to invest in their national education systems. The benefited countries in Central and South America in-cluded Ecuador, Honduras, Nicaragua, Bolivia, Paraguay, Peru, and El Salvador. In Peru, the program lasted between 2006 and 2017 and a total investment of 87,645,326 soles (about USD 27 million) was made into 47 successfully executed projects benefiting 2,300 educa-tional institutions and 174,183 people in Peru (EFE, 2017). In El Salvador, the program was implemented between 2005 and 2013; the program officially ended in October 2013, where-by USD 10 million was invested in the construction and extension of 31 educative centers, 90 schools were equipped with furniture, 1,497 teachers received trainings, and 770 educa-tional centers were equipped with a library for children (Transparencia Activa, 2016).

The problem

Since the Debt Crisis in 1982, the external debt of developing countries became a prominent concern for the international financial system, international institutions, academics, non-governmental organisations (NGOs), and official development cooperation agencies. Debt in developing countries has continued to increase in nominal terms and reached USD 2.6 tril-lion in 2004.

Until 2004, Spain was a creditor owning an external debt of more than EUR 10 billion. Of that total amount, 54% was of commercial nature; the Spanish Export Credit Insurance Company (CESCE) ensures politically risky trade with developing countries. In case of non-payment by the external importers, the CESCE indemnifies Spanish export companies, and this debt is converted into a bilateral debt between Spain and the developing country. The remaining 46% of the external debt consisted of credits issued by Spain’s Development Aid Fund (FAD) in the form of concessional loans (with interest rates below market rates) man-aged by the Official Credit Institute (ICO) that mainly serves to finance exports of Spanish goods and services to low-income developing countries.

For developing countries such as Peru and El Salvador, an external debt represents a consid-erable obstacle to their development. Resources that could be used to generate improvements to the population’s standard of living or for investments in human or physical capital are transferred abroad to meet the debt service, which includes both the amortization of the prin-cipal and the payment of interest. Therefore, international institutions such as UNESCO (Working Group on Debt Swaps for Education, 2007) have been concerned with mechanisms to relieve developing countries’ debt burden by means of debt swaps financing education (UNESCO, 2007).

Mechanism design: What is a debt-for-education swap?

There are different financial mechanisms to relieve a state's external debt. One is debt conver-sion by means of private investments. In this case, the creditor state sells the debt at a value inferior to the nominal value (for example, 50%) to an intermediary private investor, who sells it at a slightly higher value (for example, 56%) back to the indebted state. This option relieves the indebted state of the debt service of interest rates in exchange for paying a per-centage of the nominal value of the original debt.

Debt swaps provide debt relief with a higher degree of concessionality than by means of pri-vate investments, meaning the creditor state "forgives" the total sum of the debt, as it re-nounces to collect the debt. Debt-for-education swaps can be defined as "the cancellation of external debt in exchange for the debtor government's commitment to mobilise domestic re-sources (in local currency) for education spending" (Cassimon et al., 2009b). Thus, a debt swap includes a debt conversion by means of a public investment in the debtor country. In exchange for the debt concession, the debtor country constitutes a local currency fund for the value of the forgiven debt, the resources of which will be dedicated to development projects in the debtor country (Troyano et al., 2006).

Spain is part of the Paris Club that was founded in 1956: a group of officials from creditor countries whose role is to find coordinated and sustainable solutions to the payment difficul-ties experienced by debtor countries. The Paris Club was originally founded owing to Argen-tina's historic debt crisis, which motivated the French Ministry of Finance to invite Argenti-na's eleven creditor countries to a common meeting. In that regard, the negotiations within the Paris Club generally are triggered when a developing country is unable to pay its debt to the creditor country and therefore represents the potential risk of a government default, which consequently poses a threat to the international trade of the creditor country.

More recently, Spain implemented the Master Plan for Spanish Cooperation (2005–2008), which devised debt conversion programs not only as a mechanism to avoid developing coun-tries' governments to default but also as a strategic plan to improve international cooperation with emerging economies. The plan declared that debt conversions may only be undertaken in a context of normality of financial relations between a country and Spain, as well as the fi-nancial community in general, and a generally sound trading relationship within the interna-tional community (Troyano et al., 2006).

Debt swap with Peru

In 2002, the Spanish state had implemented two debt swaps as public investments in Peru, one aimed to finance the fight against drugs (1999) and the other targeting the reconstruction of educational and healthcare systems of Peru's southern zone affected by an earthquake (2002). In 2006, Spain established the Peru–Spain Fund to invest in Peru's educational system by means of a debt swap (Troyano et al., 2006) based on the decision of the Spanish Govern-ment to promote Spanish–Peruvian relations and contribute to the development of Peru.

The Peru–Spain Fund was created to convert the Peruvian government's debt into a program to finance economic growth and social development in the education sector of Peru (Agencia Española de Cooperación International para el Desarollo, 2019). The program ended in June 2017, and during the course of 11 years, it financed pedagogical projects aimed at improving the quality of teaching in regions that have high levels of poverty, such as Amazonas, Huan-cavelica, Apurímac, Ayacucho, Puno, San Martín, Huánuco, and marginal urban areas in Li-ma. The infrastructure projects aimed at the reconstruction and improvement of the educa-tional institutions' facilities as well as technical and professional trainings (Gestión, 2017).

These initiatives were developed and managed by a bilateral committee with representatives from both Spain and Peru, who analyzed the proposals and ensured their execution. The committee aimed to guarantee that the plan was aligned at all times "with Peru's technical educational lines and in collaboration with the strategic lines of the Spanish Cooperation Agency (Aecid)" (EFE, 2017).

The completion of the Peru–Spain Fund for educational development in 2017 has been con-sidered as a successful collaboration by Spanish and Peruvian authorities. Galo Herrero, eco-nomic and commercial counselor of the Embassy of Spain in Peru, claimed, “the importance of this agreement has consisted in the fact that Peru and Spain acquired the commitment to attend to the educational needs of the beneficiary communities by developing concrete and effective projects that had clear effects on local development”.

Debt-swap with El Salvador

On December 9, 2005, the Governments of El Salvador and Spain signed an agreement to convert USD 10 million of debt into educational investments in El Salvador by means of the El Salvador–Spain Fund (OEI, n.d.). An amount of USD 10 million was mobilized, of which 75% (USD 8 million) was invested in the infrastructure and equipment of educational centers, and the remaining 25% (USD 2 million) was invested in libraries and teacher trainings (Agencia Española de Cooperación Internacional para el Desarollo, 2010).

The El Salvador–Spain Fund to invest in El Salvador’s educational system was implemented in a similar fashion to the Peruvian one. A bilateral committee with representatives from Spain and El Salvador oversaw the funding and implementation of the project (Transparencia Activa, 2013).

The program benefited 150,000 students in over 100 rural municipalities mostly affected by extreme poverty. Of the 14 departments of El Salvador, 10 were beneficiaries of the program: Ahuachapán, Chalatenango, Cabañas, San Miguel, Morazán, Santa Ana, Sonsonate, Cus-catlán, and La Paz y San Vicente (Agencia Española de Cooperación Internacional para el Desarollo, 2010).

The project was also well-evaluated, and the Spanish ambassador in El Salvador, Francisco Rabena, praised the initiative: “It is important for a country to develop, so it reaches better social, political and economic development quotas every day ... we are celebrating a program that has been successful because El Salvador no longer has negative rates, in recent years it has advanced, improved its situation and therefore has advanced into a different category of a country” (Transparencia Activa, 2013).

Challenges and the case of Argentina

Debt-for-education swaps have been promoted by UNESCO and the Paris Club creditor countries to reach the Education for All goals, especially between 2004 and 2010. Nevertheless, there are some critical voices, such as the Institute of Development and Policy Management (IOB), who consider debt swap programs to be more challenging to implement than they may sound, to be too small to achieve real and noticeable development in a country, to create domestic fiscal issues by forcing large funds to be mobilized at once, to impose foreign solutions to developing countries, and to submit development projects to financial agendas (Cassimon et al., 2009a).

The limitations or difficulties of implementing debt swaps are particularly illustrative in the case of Argentina. In 2005, the Spanish government officially declared the aim of converting up to EUR 100 million into educational programs in Argentina (OEI, n.d.). This declaration followed Argentina’s other indebted countries’ joint demand to the UNESCO to endorse debt-for-education swaps as well as negotiations that were taking place with the Paris Club. Argentina was particularly eager to convert its external debt and was a leading actor in the championing of debt-for-education swaps because in 2001, it suffered a major economic crisis and its government defaulted owing to hyper-inflation paired with excessive foreign debt. The debt-for-education swap with Spain was supposed to result in an investment of EUR 100 million into the *Programa Nacional de Becas Estudiantiles* (PNBE) and *Programa Nacional de Inclusión Escolar* (PNIE), reduce drop-outs in secondary school during and after the economic crisis by awarding scholarship to 350,000 disadvantaged students (UNESCO, 2006).

Nevertheless, the debt-for-education swap was not implemented. A key issue was the international rules set by the Paris Club. The Paris Club only allows debt swaps if the International Monetary Fund (IMF) positively assesses that the debtor country's debt restructuring program helps stabilize international trade relations. However, Argentina could not reach a satisfactory agreement of debt restructuring with the IMF. At the height of negotiations in June 2005, Argentina made a one-off debt conversion offer to its creditors, whereby only 26%–30% of the debt's net value was paid to the bondholders. This offer was refused by 24% of the bondholders, and some are still in litigation processes with the Argentina government (Hornback, 2004).

This arbitration power by international institutions on high-stake and complex economic foreign debt conversions has not been without critique. According to the United Nations Conference on Commerce and Development (UNCTAD), there is a lack of international debt relief mechanisms. Further, the report from UNCTAD considers that the Paris Club and in particular the IMF are not suited to evaluate the most sustainable solution for the economic development of a debtor country (UNCTAD, 2014).

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